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# Inflation has legs

James Robertson, Jr. writes:

"Americans may be locked into their partisan corners," *The Wall Street Journal* reported last weekend, "but they are often eager to support plans for financial help from the government no matter which party's presidential candidate is offering it"—eliminating taxes on Social Security income for everyone and on tip income for service workers, just for example.

If there's anything at all to the fiscal theory of inflation—it's government overspending that ultimately causes the debasement of the currency, economist John Cochrane contends—we'll know it soon enough. Meanwhile, America is reshoring and rearming and AI-ing. Taking one thing with another, the supply of raw materials is likely to prove less accommodative than Fed Chairman Jerome Powell.

It's notable, then, that the public equities of miners, drillers and commodity producers are still well-offered and lightly bid for. Perhaps, at that, it's not so surprising. Sentiment sours when materials prices wilt and economic growth softens. The CPI for July showed a year-over-year rise of 2.9%, lowest since March 2021. And just last Wednesday, Bank of America Corp. joined Goldman Sachs Group, Inc. and JPMorgan Chase & Co. in slashing the growth prospects of the world's largest importer of natural resources.

The People's Republic is rocking the boat in exports, too, specifically in the strategic minerals and rare earths that it is prepared not to sell. Antimony is the latest example. American industrial consumers, notably munitions makers, source most of that mission-critical, lustrous grey metal from Chinese mines.

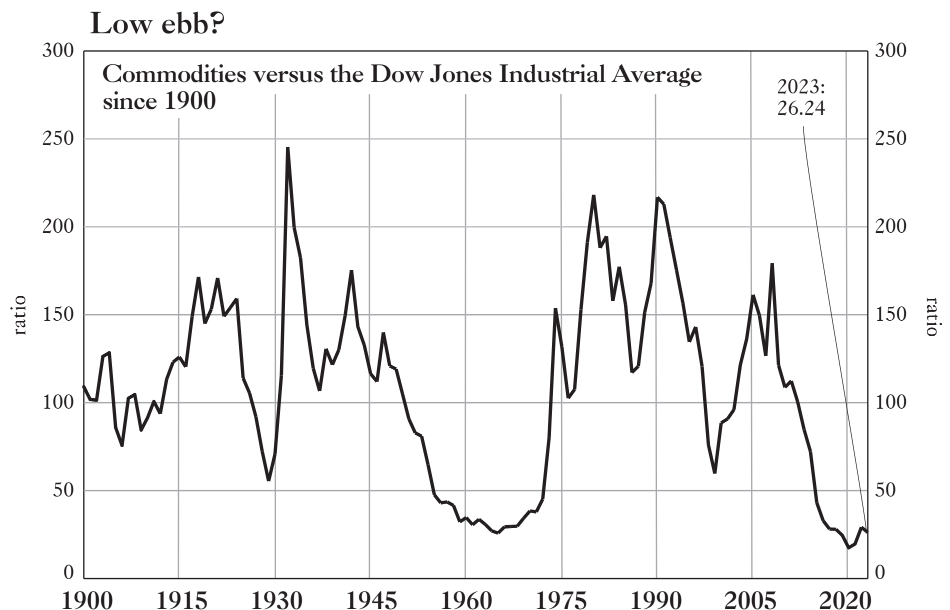
It remains to be seen how much antimony the regime will allow to leave the People's Republic, but Western makers of night-vision goggles and armor-piercing munitions require more than a little. "The United States has mined no antimony since the closure of the Sunshine Mine in Idaho in 2001," according to the Center for Strategic & International Studies. "Today, the United States meets 18% of demand through the recycling of lead-acid batteries, but is otherwise import-reliant on China (63%), Belgium (8%), India (6%) and Bolivia (4%). The United States stockpiles limited antimony of just 1,100 tons compared to the 23,000 tons consumed in 2023."

China similarly dominates world production of gallium and germanium, essential minerals in semiconductor and military applications. Since those items came under export control last year, their prices have almost doubled.

Washington's own list of export-controlled materials last week lengthened with the addition of quantum computers and advanced chip-making tools. Whatever the merits of blacklisting, export controls and import tariffs, they make no direct contribution to the cause of disinflation. And both leading American presidential candidates seem just as committed to fighting a tit-for-tat trade war with China as they do to forging ever-larger U.S. fiscal deficits.

Cyclical volatility, too, contributes

**Low ebb?**




source: Goehring & Rozencwajg Associates, LLC

to inflationary pressures. Although Friday's nonfarm payroll report for August missed expectations by some 23,000 jobs, the employment picture brightened from July. Besides, the average workweek lengthened and wage growth registered at 4% year over year. "Companies do not lengthen the workweek and increase wages when economic conditions are soft," comments economist Joseph Carson via the *Barron's* columnist Randall Forsyth.

James Bianco, eponym of Bianco Research, LLC, sensibly warns that the Fed, by cutting rates at the next meeting, risks stimulating an overwarm labor market and reigniting the inflation that the mandarins hope they may have seen the back of.

Such are the drivers of an inflation regime change, according to our friend Murray Stahl, chairman and chief executive officer of Horizon Kinetics, LLC, and they mark a clear shift from the low-inflation environment of the past few decades.

Consider, says Stahl, the sea change in economic geography. The combined GDP of the so-called BRICS-plus countries (Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia, the United Arab Emirates) weighed in at $28 trillion in 2023 when measured on a nominal basis and at no less than $67 trillion when measured on a purchasing-power parity basis. The nominal measure is considerably smaller than the $46 trillion combined GDP of the United States and the European Union. However, the PPP-adjusted measure is significantly larger than the PPP-adjusted U.S. and EU GDP of $54.5 trillion. In any case, says Stahl, the economic West (in which, for this calculation, he omits Japan) no longer holds the economic sway it once did.

Dealing with the brave, new multipolar world, the United States is turning inward—reshoring—to produce semiconductors, munitions, pharmaceuticals, solar panels and minerals. The Biden administration, in April, awarded Taiwan Semiconductor Manufacturing Co. Ltd. $6.6 billion in grants and $5 billion in low-interest loans for the construction of long-planned chip-fabrication plants.

It's a sign of the times that the project has hit such 1970s-style snags as soaring costs, stretched timelines and labor shortages. According to sources quoted by *Nikkei Asia*, the cost of construction in Arizona has ballooned to "several times" the estimates that the planners cast just three or four years ago. Once completed, the first fab will guzzle 4.75 million gallons of water a day.

Data centers that use chips like the ones that the Arizona TSMC will produce are themselves straining available resources. The utility company overseeing Northern Virgina's data-center alley, Dominion Energy, Inc., last month served notice that it "expects the time it takes to connect large data centers to the electric grid to increase by one to three years, amid a surge of requests, bringing the total wait time to as long as seven years."

Power availability, material shortages, permitting and regulations have pushed Alphabet, Inc., OpenAI and Microsoft Corp. to change their construction strategy. The new approach is to build more and smaller data centers with which to train their language models (all to the end of trying to outscale the competition), according to the Substack newsletter SemiAnalysis.

In response to a question on the cost of AI infrastructure during the second-quarter earnings call, Alphabet CEO Sundar Pichai replied that "the risk of under-investing is dramatically greater than the risk of over-investing. This infrastructure is widely useful for us."

Pichai isn't alone in Silicon Valley in hoping to meet ravenous AI energy demands with nonfossil fuels. It will be easier said than done, contends Adam Rozencwajg, managing partner of commodity investors Goehring & Rozencwajg Associates, LLC. There will be little additional capacity from nuclear. And there will forever be intermittency problems with renewables. Gas is a logical choice to fill in the blanks. Logical and currently cheap: West Texas spot gas trades at minus $0.88 per million British thermal units.

Data centers could boost the demand for natural gas by between 7 billion and 16 billion cubic feet a day by 2030, according to Wells Fargo analysts led by Michael Blum, on top of the 35 Bcf/d used currently in the power sector. It's incremental demand that coincides with the arrival of new or expanded liquefied-natural-gas export terminals. According to the U.S. Energy Information Administration, terminals with the combined capacity of 6 Bcf/d are coming online in the next 18 months.

Back-to-back mild winters and a production boom in the shales are responsible for driving Henry Hub gas prices to $2 per million BTU from their $9 highs in 2022. At an energy-equivalent discount to West Texas crude prices of 81%, Henry Hub prices are the cheapest since the winter of 2011–12.

A reversal could lift the very same prices to $9 or $10, says Rozencwajg, as LNG and data-center construction ramps up. He predicts that the gas supply overhang—accumulated over balmy winters and periods of overproduction—will vanish by year end.

To say that the market is not expecting such an outcome would be an understatement. The S&P 500 Energy Index trades at 12.2 times trailing net income versus 23.3 times for the broad S&P index. Rozencwajg is bullish on such E&P gas producers as Range Resources Corp. (RRC on the New York Stock Exchange) which trades at 13.8 times earnings and commands access to Tier 1 drilling locations in the Pennsylvania portion of the Marcellus shale play. Another is EQT Corp. (EQT, also on the Big Board), valued at 23.2 times earnings, which drills in Pennsylvania, West Virginia and Texas.

Since inception, the Horizon Kinetics Inflationary Beneficiaries ETF (INFL on the NYSE Arca; *Grant's*, Nov. 27, 2020) has generated an annualized return of 11.35%, including reinvested dividends, versus 12.24% for the S&P 500.

The ETF got off to a slow start, as Stahl acknowledged post-launch (*Grant's*, Sept. 17, 2021), but it has received an upside jolt from a new investment in LandBridge Co., LLC (LB on NYSE). The owner of land in the Delaware Basin of the Permian shale, LandBridge leases its acres to oil-field service companies. One day, Stahl says, data centers, too, may be paying rent. Since its IPO on June 27, LB has doubled, to $34 a share from $17. Horizon Kinetics is the largest public shareholder, and LB makes up 6.54% of INFL.

The top five positions in INFL's asset-lite, high-margin portfolio comprise Texas Pacific Land Corp., Viper Energy, Inc., Wheaton Precious Metals Corp. and Prairie Sky Royalties Ltd. Oil and gas make up 31% of the holdings; mining, 19.4%; financial services, including stock exchanges, 18%; and agriculture, 6.9%.

Top performing positions include Viper Energy, Inc. (VNOM on Nasdaq), up 283% (44% annualized) since

inception with dividends reinvested; Permian Basin Royalty Trust (PBT on NYSE), up 269% (43% annualized); and Texas Pacific Land Corp. (TPL on NYSE), up 181% (33%). Deterra Royalties Ltd., a battery-metal royalty company which fell 9.3% since inception on a dollar basis, features among the dullards.

"They can accomplish, I'm sure, great things with artificial intelligence," says Stahl. "It just requires resources that—at least some of them—are subject to inflationary pressures."

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| As of July 31, 2024 | YTD 2024 | 1 Year | 3 Year | Since Inception | YTD 2021 | 2022 | 2023 |
|---|---|---|---|---|---|---|---|
| INFL (Market) | 16.11 | 14.49 | 7.93 | 12.65 | 26.96 | 2.64 | 1.62 |
| INFL (NAV) | 16.10 | 14.61 | 7.99 | 12.70 | 26.98 | 2.57 | 1.86 |

Inception date: Jan 11, 2021

Any performance data quoted represents past performance and does not guarantee future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when sold or redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than the performance quoted. For performance current to most recent month end please call 646-495-7333.

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The Fund is non-diversified, meaning it may concentrate its assets in fewer individual holdings than a diversified fund. Therefore, the Fund is more exposed to individual stock volatility than a diversified fund.
Fund holdings and sector allocations are subject to change at any time and should not be considered recommendations to buy or sell any security.
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DEFINITIONS
CPI: The Consumer Price Index (CPI) is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.
P/E Ratio: Price Earnings Ratio is the relationship between a company's stock price and earnings per share.
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